

<b>STATE OF MONTANA</b> <b>COMPLIANCE SUPPLEMENT FOR AUDITS OF</b> <b>LOCAL GOVERNMENT ENTITIES</b>	REF: C/T-4
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<b>PROGRAM/SUBJECT:     Cities and Towns - Cash and Investments</b>	

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**COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**CUSTODIAN OF PUBLIC MONEY:**

**1. Compliance Requirement:**

- The municipal treasurer shall receive, disburse, and serve as the custodian of all public money; provide for accountability of all local government cash receipts and for deposits and investments of all departments, offices, and boards; pay out, in the order registered, all warrants presented for payment when there are funds in the treasury to pay the warrants; and require periodic departmental reports of money receipts and their disposition on forms that the municipal treasurer prescribes. (MCA 7-6-612)

**Suggested Audit Procedures:**

- Determine that the treasurer receives, disburses, and serves as the custodian of all public money of the municipality.
- Determine that the treasurer provides for accountability of all local government cash receipts and for deposits and investments of all departments, offices, and boards.
- Determine that the treasurer pays out, in the order registered, all warrants presented for payment when there are funds in the treasury to pay the warrants.
- Determine that the treasurer requires periodic departmental reports of money receipts and their disposition on forms prescribed by the treasurer.

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## **COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

### **DEPOSITORIES FOR PUBLIC MONEY:**

#### **2. Compliance Requirements:**

- A city or town may only invest in the following: (MCA 7-6-202, 7-6-206, 7-6-213, and 17-6-204)
  - a. United States government treasury bills, notes, and bonds, and United States treasury obligations, such as state and local government series (SLGS), separate trading of registered interest and principal of securities (STRIPS), or similar United States treasury obligations. (MCA 7-6-202)
  - b. United States treasury receipts in a form evidencing the holder's ownership of future interest or principal payments on specific United States treasury obligations that, in the absence of payment default by the United States, are held in a special custody account by an independent trust company in a certificate or book-entry form with the Federal Reserve Bank of New York. (MCA 7-6-202)
  - c. obligations of the following agencies of the United States:
    - i. Federal Home Loan Bank;
    - ii. Federal National Mortgage Association;
    - iii. Federal Home Mortgage Corporation; and
    - iv. Federal Farm Credit Bank.
 (MCA 7-6-202)
 

**(Note:** An investment in an agency of the United States must be a general obligation of the agency and have a fixed or zero-coupon rate and must not have prepayments that are based on underlying assets or collateral, including but not limited to residential or commercial mortgages, farm loans, multifamily housing loans, or student loans. (MCA 7-6-202))
  - d. a United States government security money market fund if: (MCA 7-6-202)
    - i. the fund is sold and managed by a management-type investment company or investment trust registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 through 80a-64), as may be amended;
    - ii. the fund consists only of eligible securities as described above;
    - iii. the use of repurchase agreements is limited to agreements that are fully collateralized by the eligible securities, as described in this section, and the investment company or investment trust takes delivery of the collateral for any repurchase agreement, either directly or through an authorized custodian;
    - iv. the fund is listed in a national financial publication under the category of "money market mutual funds", showing the fund's average maturity, yield, and asset size; and
    - v. the fund's average maturity does not exceed 397 days.
  - e. time or savings deposits with a bank, savings and loan association, or credit union in the state. (MCA 7-6-206)
  - f. repurchase agreements, as provided in 7-6-213. (MCA 7-6-206)
  - g. the State Short-Term Investment Pool (STIP), as provided in 17-6-204. (MCA 7-6-202)

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## **COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

### **DEPOSITORIES FOR PUBLIC MONEY - continued:**

#### **2. Compliance Requirements - continued:**

- (**Note:** There is no express or implied limitation on a county treasurer's ability to use the services of an investment or brokerage firm to purchase approved securities; however, an investment company may not be used in making demand or time deposits because that form of transaction is restricted to banks, savings and loan associations, and credit unions. (AGO #25, Vol. 42.) Although, this AGO is specific to a county treasurer the same holding would also apply to a municipality.)
- **Out-of-state certificates of deposit** - In addition to the investments authorized above, public money not necessary for immediate use by a city or town may be invested in accordance with the following conditions:
    - (a) the money is initially invested through a federally insured financial institution in the state selected by the governing body;
    - (b) the selected in-state financial institution arranges for the deposit of the funds in certificates of deposit for the account of the city or town in one or more federally insured financial institutions, regardless of location;
    - (c) the full amount of principal and accrued interest on each certificate of deposit is covered by federal deposit insurance;
    - (d) the selected in-state financial institution acts as the custodian for the city or town with respect to the certificates of deposit issued for its account; and
    - (e) at the same time that the city or town money is deposited and the certificates of deposit are issued, the selected in-state financial institution receives an amount of deposits from customers of other federally insured financial institutions, regardless of location, equal to or greater than the amount of money initially invested by the city or town through the selected in-state financial institution. (MCA 7-6-206(3))
  - Investments may not have a maturity date exceeding 5 years, except when the investment is used in an escrow account to refund an outstanding bond issue in advance. (MCA 7-6-202(4))
 

(**Note:** See exception in following compliance requirement.)
  - An investment of the assets of a local government group self-insurance program established pursuant to MCA 2-9-211, or MCA 39-71-2103, may not have a maturity date exceeding 10 years, and the average maturity of all those authorized investments of a local government group self-insurance program may not exceed 6 years. (MCA 7-6-202(5))

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## **COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

### **DEPOSITORIES FOR PUBLIC MONEY - continued:**

#### **2.     Compliance Requirements - continued:**

- Revisions made to MCA 7-6-202, by the 1995 Legislature were effective upon passage and approval, which was on April 13, 1995. An applicability clause in the legislation specified that these revisions do not apply to and do not require the sale of securities that were legal investments before this effective date. However, upon liquidation of such investments, the proceeds must be invested pursuant to the revised MCA 7-6-202. This applicability clause has been interpreted to mean that mutual fund dividends may not be reinvested after the effective date unless the mutual fund is a United States government security money market fund meeting the criteria specified in the MCA 7-6-202(3), as revised.

#### **Suggested Audit Procedure:**

- Review selected investments, including both investments held at year-end and during the fiscal year, to determine if the types of investments are authorized by state law.
- Review selected investments, including both investments held at year-end and during the fiscal year, and verify that investments do not have a maturity date exceeding 5 years, except as discussed above.

#### **3.     Compliance Requirements:**

- Demand deposits may be placed only in banks. (MCA 7-6-205)
- Except as provided in MCA 7-6-202 (investments), MCA 7-6-206 (time deposits and repurchase agreements), and MCA 7-6-2701 (registered warrants), it shall be the duty of all city treasurers and town clerks to deposit all public money in their possession and under their control in any solvent banks, building and loan associations, savings and loan associations, or credit unions located in the city or town of which such treasurer is an officer, subject to national supervision or state examination as the local governing body may designate. (MCA 7-6-201 and 7-6-4601)

#### **Suggested Audit Procedures:**

- Determine that demand deposits are only placed in banks.
- Determine that all public money is deposited in banks, building and loan associations, savings and loan associations, or credit unions located in the city or town, except as provided in MCA 7-6-202 (investments), 7-6-206 (time deposits and repurchase agreements), and 7-6-2701 (registered warrants).

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## **COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

### **DEPOSITORIES FOR PUBLIC MONEY - continued:**

#### **4. Compliance Requirement:**

- When the city or town has money for which there is no immediate demand (excluding money realized from the proceeds of bonds), the city or town may invest in city or town warrants. The city/town council may direct the treasurer or clerk to purchase legally issued general obligation warrants that were issued against funds in which there are not sufficient funds to pay such warrants at the time of issuance. The city/town council shall designate the fund or funds to be invested and designate the warrants to be purchased. The warrants will be registered and bear interest. (MCA 7-6-4603)

#### **Suggested Audit Procedure:**

- Review investments to determine if the city or town has invested in its own registered warrants. If it has, review the minutes or other documentation to determine if the council authorized the city treasurer or town clerk to purchase the warrants, and determine that the registered warrants are paying interest at a rate set by the council.

#### **5. Compliance Requirement:**

- Whenever the city or town has under its control any money realized from the sale of bonds, for which there is no immediate demand and which in the judgment of the city or town council it would be advantageous to invest in any time or savings deposits, United States certificates of indebtedness, United States treasury notes, or United States treasury bonds having a maturity date of 1 year or less, the city or town council is authorized in their discretion to direct the city treasurer or town clerk to make such investments. (MCA 7-7-4102)

#### **Suggested Audit Procedure:**

- Review long-term debt files and determine if the city or town has invested any money realized from the sale of bonds. If it has, review the minutes and investment ledgers or other documentation to determine if the money was invested as describe above.

### **BIDS FOR DEPOSITS AND INVESTMENTS:**

#### **6. Compliance Requirement:**

- The city or town may solicit bids for time deposits or savings deposits from banks, savings and loan associations, or credit unions within the state. Bids for repurchase agreements may be solicited from all financial institutions chartered to do business in the state which are authorized to accept demand deposits and to buy and sell securities. The city or town may deposit money in the institutions unless a local

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## **COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

### **BIDS FOR DEPOSITS AND INVESTMENTS - continued:**

#### **6.    Compliance Requirement - continued:**

financial institution located within the city or town agrees to pay the same rate of interest. The governing body may solicit bids by mail to the institutions that have requested that their names be listed for bid notice with the Department of Administration. (MCA 7-6-206 and 7-6-213)

#### **Suggested Audit Procedure:**

- If the city or town solicits bids for investments, review the documentation regarding the interest rates presented during the bidding process. If the interest rates for local and non-local institutions are the same, determine that the local financial institution was chosen.

### **INTEREST RATES ON DEPOSITS OF PUBLIC MONEY:**

#### **7.    Compliance Requirement:**

- The rate of interest paid to the city or town must be the same as that paid on money from private sources on the same terms. Refusal of any bank, building and loan association, savings and loan association, or credit union to pay that same interest rate shall constitute a waiver of that institution's right to participate in the deposit of public funds. (MCA 7-6-203 and 7-6-4602)

#### **Suggested Audit Procedure:**

- If, based on the auditor's knowledge and background, it is discovered during the audit that interest paid to the city or town may not be the same as the interest that is paid on money from private sources on the same terms, the matter should be investigated further and disclosed if it can be documented that a lower interest rate was paid to the city or town.

### **PLEDGED SECURITIES:**

#### **8.    Compliance Requirement:**

- The city or town may require security for that portion of the deposits in financial institutions that are not guaranteed or insured according to law. The local government can require security to the extent of:
  - a. 50% of the deposits if the financial institution has a net worth to total assets ratio of 6% or more; or
  - b. 100% of the deposits if the financial institution has a net worth to total asset ratio of less than 6%.
 (MCA 7-6-207)

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## **COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

### **PLEDGED SECURITIES - continued:**

#### **8. Compliance Requirements - continued:**

(**Note:** The coverage rates for public funds that are insured by the Federal Deposit Insurance (FDIC) and National Credit Union Administration (NCUA) are as follows:

- (a) Up to \$100,000 in the aggregate for all time and savings deposits (share certificates and regular share accounts for credit unions); and
- (b) Up to \$100,000 in the aggregate for all demand deposits (draft accounts for credit unions).([12 C.F.R. Part 330.15](#) & 745.10).

#### **Suggested Audit Procedure:**

- If the city or town has deposits in a financial institution that are not guaranteed or insured according to law, obtain the published statement of condition for the financial institution to determine the financial institution's net worth to total assets ratio. Determine that the amount of securities pledged by the financial institution to protect those deposits that are not guaranteed or insured according to law is at least equal to the amounts required by state law, as described above.

#### **9. Compliance Requirements:**

- Pledged securities must consist of those specified in MCA 17-6-103 or cashier's checks issued to the depository institution by any federal reserve bank.. (MCA 7-6-207)
- When negotiable securities are furnished, the city or town governing body must make a complete minute entry of the acceptance and approval of such securities. If a financial institution substitutes securities, the governing body shall approve the substitution at its next official meeting. After negotiable securities have been approved, the governing body must reapprove them at least quarter-annually thereafter. (MCA 7-6-207 & 208)

#### **Suggested Audit Procedures:**

- Determine the type of securities pledged to protect the city's or town's deposits and determine that they comply with the requirements of MCA 17-6-103.
- Determine that the acceptance and approval of negotiable pledged securities is noted in the minutes of meetings of the city or town governing body. Determine, also, that the governing body reapproves these securities at least quarter-annually, and that this reapproval is noted in the minutes.
- Determine that the substitution of pledged securities is approved by the city or town governing body.

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## **COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

### **PETTY CASH FUND:**

#### **10. Compliance Requirement:**

- A municipal governing body may set aside a sum out of the general fund, which must be known as a petty cash fund. The petty cash fund must be used for the purpose of paying incidental expenses, such as freight charges, express charges, postage, and other similar expenses that must be immediately paid in cash. (MCA 7-6-615)

#### **Suggested Audit Procedures:**

- Determine if the city or town maintains a petty cash fund and verify that it is only used for the paying incidental expenses, such as freight charges, express charges, postage, and other similar expenses that must be immediately paid in cash.
- Verify that the petty cash fund has been authorized by the governing body and has been set up and maintained on the imprest basis.

### **CASH TRANSFERRED TO OTHER FUNDS:**

#### **11. Compliance Requirement:**

- Money may not be transferred from one fund to another except by resolution of a municipal governing body unless the transfer is:
  - (1) previously authorized by a budget resolution;
  - (2) to close inactive funds, as provided by MCA 7-6-614;
  - (3) made in the usual course of municipal business for:
    - a. tax increment finance districts;
    - b. specialized tax situations;
    - c. the purpose of distributing refunds, protested taxes, or interest charges for interest in lieu of registered warrants;
    - d. bond sinking fund transfers;
    - e. residual equity transfers;
    - f. transfers of investments;
    - g. or corrections of errors; or
  - (4) otherwise authorized by statute.
 (MCA 7-6-613)

#### **Suggested Audit Procedure:**

- As part of cash testing, determine that cash transfers were only made for those purposes specified in MCA 7-6-613.